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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 237

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.,
Petitioner,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA and THE EQUITY ANNUITY LIFE INSURANCE COMPANY,
Respondents.

No. 290

SECURITIES AND EXCHANGE COMMISSION, *Petitioner,*

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA and THE EQUITY ANNUITY LIFE INSURANCE COMPANY,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR RESPONDENT VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA IN OPPOSITION

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BRIEF FOR RESPONDENT VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA IN OPPOSITION

The intervening plaintiff NASD and plaintiff SEC[1]

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[1] ABBREVIATIONS AND EMPHASIS:

Parties: NASD—National Association of Securities Dealers, Inc.; SEC—Securities and Exchange Commission; VALIC—

separately petition for a writ of certiorari, requesting that this Court review the judgment of the United States Court of Appeals for the District of Columbia Circuit (— U.S. App. D.C. —, — F. 2d —, printed NASD Pet. 31-39), which unanimously affirmed the judgment of the United States District Court for the District of Columbia (155 F. Supp. 521, printed R. 82), dismissing with prejudice the SEC complaint against VALIC.

QUESTIONS PRESENTED

In stating their versions of the questions presented, NASD/SEC assume the validity of positions urged by them and rejected by both the District Court and the Court of Appeals. An accurate statement of the questions involved is:

It being undisputed that VALIC is a life insurance company organized under the Life Insurance Act of the District of Columbia and is engaged in the sale of life insurance and variable life annuity contracts with the approval and under the supervision of the Superintendent of Insurance of the District of Columbia and the coordinate insurance administrators of the states in which it operates—

Did the Court of Appeals err in holding that VALIC:

Variable Annuity Life Insurance Company of America, EALIC—The Equity Annuity Life Insurance Company of America.

Record: NASD Pet.—NASD Petition for Writ of Certiorari; SEC Pet.—SEC Petition for Writ of Certiorari; R.—Joint Appendix printed for use of Court of Appeals; F.F.—Findings of Fact of trial court; P. Ex. and D. Ex.—trial court exhibits of plaintiffs or of either defendant.

All emphasis added unless otherwise indicated.

(i) is excluded from the regulatory jurisdiction of SEC by the McCarran-Ferguson Insurance Regulation Act (Act of March 9, 1945, c. 20; 59 Stat. 33, as amended; 15 U.S.C. §§ 1011-1015);

(ii) is not required to register its contracts with SEC under the Securities Act of 1933 (Act of May 27, 1933, c. 38; 48 Stat. 74; 15 U.S.C. §§ 77a et seq.); and

(iii) is not an "investment company" subject to the Investment Company Act of 1940 (Act of August 22, 1940, c. 868; 54 Stat. 789; 15 U.S.C. §§ 80a-1 et seq.).

STATUTES INVOLVED

NASD in Appendix A and SEC in Appendix B of their respective petitions set forth the statutory provisions which they deem pertinent.

The McCarran-Ferguson Insurance Regulation Act is printed in full in Appendix I, pp. 29-30, *infra*.

Also involved is Title 35 of the District of Columbia Code (1951), particularly Chapters 3-8 thereof, being the "Life Insurance Act", hereafter sometimes cited "L.I.A." It is not feasible to reprint this entire title as an Appendix to this Brief.

PETITIONERS' STATEMENTS OF THE CASE

Petitioners' Statements of the Case, largely unsupported by Record references, attempt to translate VALIC's insurance operations into inappropriate securities language (e.g., "investor," "promoter," "shares,") and by this semantic device seek to distort the undisputed evidence, the Findings of the Trial Court, and the Opinion of the Court of Appeals. Respondent cannot accept such a Statement.

RESPONDENT'S STATEMENT OF CASE

I. VALIC is a life insurance company, with corporate authority to engage in—and limited to—the business of insurance[2]

VALIC is a life insurance company, capital and unassigned surplus over $600,000, chartered December 30, 1955, under the Life Insurance Act.

VALIC is authorized by its charter:

> ". . . to engage in the Life Insurance business, *writing life insurance,* [*disability insurance*] *and variable annuities* in combination policies, and for the assumption and ceding of reinsurance written *appertaining to persons as such business is now or may hereafter be regulated by the . . . 'Life Insurance Act,'* . . . .
>
> "As an exemplification . . . the following shall be the business of the Company:
>
> "(a) To grant, purchase or dispose of life [and disability] insurance policies, and variable annuity policies stated in terms of units, the value of which is based in whole or in part on equity type of investments permitted by Section 535 of Title 35 of said 'Life Insurance Act' . . ." (Bracketed material added by amendment.)

The District Insurance Superintendent, acting pursuant to L.I.A. §§ 35-503 and 35-705, approved VALIC's certificate of incorporation and issued its certificate of authority. The District Corporation Counsel on three occasions has certified that VALIC's

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[2] The authorities for this summary of VALIC's operation are F.F. 3-15, 19-21, and 27, R. 94-99; R. 506; D.Ex. 2, R. 406, 814; D.Exs. 6 and 8, R. 406, 817; D.Exs. 13 and 15, R. 406, 823; and D.Ex. 20, R. 406, 832. To avoid prolixity, they are not individually cited.

purpose and corporate structure conform to the District Insurance Law (L.I.A. § 35-503).

The insurance commissioners of West Virginia, Kentucky, and Arkansas likewise have authorized VALIC to transact its business in their respective states.

Each VALIC policy form has the approval of the District Insurance Superintendent (L.I.A. § 35-705) and the insurance commissioner of each state in which VALIC transacts business (R. 506).

In the District and in each state where VALIC operates, statutes provide for detailed supervision of its activities by the insurance authorities. In West Virginia and Arkansas the insurance departments have promulgated regulations specifically applicable to insurance companies offering variable annuity policies. The statutes and regulations assure the most exhaustive supervision by insurance authorities expert in their field.

> ". . . [The] business of insurance has been more generally regulated than any other sphere of business activities not a public utility." *American Hospital & Life Ins. Co.* v. *Federal Trade Commission*, 243 F.2d 719 at 721 (5th Cir. 1957), aff'd *Federal Trade Commission* v. *National Casualty Co.*, — U.S. —, 78 S. Ct. 1260 (June 30, 1958).

II. VALIC's sole business is the sale of life insurance and life annuity contracts.

The variable annuity is an annuity providing a life income, not in a fixed number of dollars, but in variable dollar amounts determined by precise means fixed by the contract, and keyed to the investment results of the insurance company's investable assets.

Variable annuities differ from fixed-dollar annuities only in that the former provide a contractually precise method of relating the insurance company's experience with its investable assets to the annuity benefits payable to the contract holder (R. 471).

Variable annuities provide the annuitant the assurance of a retirement income for life (NASD/SEC expert, R. 281-2); and are "a means of providing a retirement program under which benefit payments tend to vary with cost of living changes" (F.F. 29, R. 100). VALIC's life annuity contract assures the annuitant periodic payments in dollar amounts *and continuing for the uncertain period—long or short—of the life or lives of the annuitant or annuitants* (F.F. 30, R. 100. See also F.F. 29, R. 100).

Variable life annuity contracts are issued, and can lawfully be sold, only by regulated life insurance companies (R. 441). No investment company ever has, or can lawfully underwrite the mortality guarantees that are the annuity's inherent nature.

The District Insurance Superintendent has approved for VALIC eight forms of contracts (F.F. 31, R. 101), seven of which NASD/SEC have ignored throughout this litigation. The seven policy forms ignored by NASD/SEC are three individual single premium immediate variable annuities (Pl. Ex. 7, R. 206, 677—life annuity with no refund at death; Pl. Ex. 8, R. 207, 681—joint and last survivor annuity with no refund at death of last survivor; Pl. Ex. 9, R. 208, 685—life annuity, ten years guaranteed); three group policies (Pl. Ex. 10, R. 208, 689—pension trust; Pl. Ex. 11, R. 209, 701—group deposit administration; Pl. Ex. 12,

R. 210, 713—group, money or unit purchase);[3] and a "family protection" policy (D. Ex. 29, R. 840). For reasons never explained NASD/SEC focus their attack on the individual deferred annuity policy.

Life insurance companies, through their various types and forms of life annuity contracts, perform the basic insurance function of combining a large number of exposure units (annuitants) so that a group aggregate of assets may be liquidated over the uncertain life spans of the group (NASD/SEC expert, R. 220). The risk involved in longevity: the danger of outliving one's earning power and one's savings. Though the insurer cannot foresee how long any one annuitant will live, mortality tables and actuarial science provide the basis for estimating the average lifetimes of groups (NASD/SEC expert, R. 254-257; see also 456-459).

Each annuitant in effect agrees that if the insurer (by assuming and distributing the mortality risk) will guarantee payments through his life ("the status for which the contract provides": NASD/SEC expert, R. 194), then he will accept forfeiture in the event of his early death so that his unused reserve[4] may inure to the benefit of the group. As an NASD/SEC expert explained (R. 255), VALIC guarantees mortality. A company guaranteeing mortality must "have some mortality profits on early deaths to offset the loss on deaths later on" (R. 255).

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[3] The major portion of the life insurance annuity business today is in the group annuity field. (NASD/SEC expert, R. 257)

[4] The valuation of VALIC's reserves has been examined and certified by the District Insurance Superintendent (D.Ex. 1, R. 270, 812). The adequacy of VALIC's reserve was not disputed by the NASD/SEC actuarial expert (R. 275).

Variable and fixed-dollar life annuities are identical from the standpoint of insurance principles (R. 470). The life insurance companies apply to each the same specialized actuarial knowledge and techniques (R. 487). This actuarial science, uniquely an aspect of the insurance business (NASD/SEC expert, R. 126-127), forms part of the fundamental know-how of state insurance authorities, whose duty it is to determine the fairness and soundness of all life insurance contracts. It is wholly foreign to the security business or to security regulation (NASD/SEC expert, R. 215).

Only one unfamiliar with life insurance could assert (NASD Pet. p. 5, without supporting record citation) that "there is no life contingency involved in the pay-in period." VALIC's deferred life annuity contract, issued today, guarantees that at retirement, often decades hence, annuity payments starting at a specified dollar amount and varying thereafter only to the extent that VALIC's net investment results vary from an assumed 3½%, will continue throughout the life of the annuitant (F.F. 30, 33-A-i, R. 100, 102; NASD/SEC expert, R. 255). *VALIC assumes this mortality risk the day it issues the contract* (R. 461, 463-65; NASD/SEC expert, R. 221, 248-250).

The nature of this insurance risk is evident from the numerous mortality tables which insurance actuaries have developed over the past 70 years to provide for improving mortality (NASD/SEC expert, R. 250). Annuity contracts still in force, issued 50 or more years ago and based on then current mortality tables, today commit American insurance companies to payments substantially in excess of those now

offered in the light of present-day knowledge of mortality experience.

In the administration of its insurance obligations, VALIC employs statistical devices referred to as "accumulation units" and "annuity units." The trial court found: "The 'accumulation unit' is a symbol designed and used for the purpose of keeping the policyholder informed as to the cash surrender value of his policy and the investment experience of the company. . . . *VALIC has no account reflecting 'accumulation units'. 'Accumulation units' have no function in the actuarial operations of the company*" (F.F. 36, R. 105, emphasis added). The trial court also found: "The 'annuity unit' is a symbol designed and used to keep the annuitant or beneficiary informed as to the measure of his annuity payment, and the investment experience of the company . . . *'Annuity units' do not appear on the books of account of VALIC*" (F.F. 37, R. 105, emphasis added). VALIC, like all life insurance companies, keeps its books of account on a cash basis (R. 524, 549), and the statistical symbols are mere mechanical details of the insurance operations of the company, and are so treated in the opinion of the Court of Appeals.

Petitioners argue that VALIC has an "investment fund" (NASD Pet. 4); and that the policyholder has a "share" or "interest" therein (SEC Pet. 4-5).[5] The reserves of VALIC are not a "fund", since each reserve represents a *liability* determined by actuarial calculations (R. 549, 555). That such reserves are liabilities, not assets, (R. 564) is agreed upon by all

[5] SEC abandoned Count Three of the Complaint (R. 6) which alleged that VALIC was a depositor and underwriter of a "Fund".

insurance authorities (NASD/SEC expert, R. 117).[6] When VALIC issues life insurance and annuity policies, it collects premiums. From these premium receipts VALIC makes investments (including the purchase of equities) for its own account. Such investments are VALIC's assets, owned and held by it to meet it liabilities under outstanding policies (R. 549).

The investment securities acquired by VALIC do not pass, by sale or exchange or otherwise, to any "fund," to any annuitant or to anyone else. (R. 515-16, 549) Neither does an annuitant or anyone else have an aliquot share in the investment securities. VALIC's policyholders, like those of any insurance company, *are general creditors* who look to all the company's assets for performance of its contractual obligations. That is the sum of their "interest" in VALIC's assets.[7]

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[6] "A liability exists wherever a company is 'liable' (bound or obligated) to pay out assets now or in the future. *Thus the policy reserves of a company are not assets but liabilities* . . . Because the reserve creates a need for assets, it is common to refer to the reserve as 'a fund.' For the purposes of a non-technical discussion, the misnomer is of little consequence; in fact, it is often difficult and awkward to avoid such reference. However, *the reserve is not a 'fund' because it is a liability,* and a liability is an accounting measure of obligations." (p. 556) Mehr & Osler Modern Life Insurance, 553-556 (1956). See also Maclean, Life Insurance (17-18) (1957).

[7] All VALIC's assets stand behind its obligations and guarantees (SEC expert, R. 282, 296). VALIC's assets as of March 1, 1957, were nearly $640,000 (P. Ex. 4, R. 648). This is over eight times the total annual premium payable on all annuity policies in force ($74,824.51, R. 540).

REASONS FOR DENYING THE WRITS

I

The Court of Appeals held that the McCarran-Ferguson Act, the Securities Act of 1933 and the Investment Company Act of 1940 "show an *unmistakable* determination on the part of Congress to leave the insurance business *in the control of the States* until Congress should in plain terms exert its power over some or all aspects of it."

This Court, in *Federal Trade Commission* v. *National Casualty Co., et al* — U.S. —, 78 S. Ct. 1260 (June 30, 1958), held: "An examination of [the McCarran-Ferguson Act] . . . and its legislative history establishes that the Act withdrew from the Federal Trade Commission the authority to regulate respondents' [insurance companies'] advertising practices in those States which are regulating those practices under their own laws."

The decision of the Court of Appeals thus falls squarely within the holding of this Court in *Federal Trade Commission* v. *National Casualty Co.* Faced with this inescapable bar to their petition, NASD/SEC seek to summarily dispose of the *National Casualty* decision with footnote comments that it is "inapposite" (NASD Pet. p. 10), or that it "has no present bearing" (SEC Pet. p. 15). In truth, no decision could be more "apposite," or have a more decisive bearing.

The present action is an *a fortiori* situation. NASD/SEC do not deny that VALIC is a *life insurance company,* or that the *insurance* commis-

sioners have exercised, and are exercising their regulatory powers with respect to its operations. The District and state insurance officials have authorized VALIC's incorporation and operation, received its security deposit, approved its variable life annuity policies, examined its accounts, valued and certified its policy reserves, received its annual reports and licensed its agents—all under controlling *insurance* statutes.

The most casual examination of the 253 sections of Title 35 of the District of Columbia Code will dispel any spurious anxiety which NASD/SEC may profess for VALIC's policyholders:[8] The District Insurance Superintendent has "supervision of all matters pertaining to insurance companies, subject only to the general supervison of the Commissioners" (§ 35-101 D. C. Code). The reports on file with him are public. Every detail of the organization of a company, the policies it issues, the operations of its home office, the sales activities of its agents, is fully regulated, not merely as to "full disclosure", but also to assure continuing fairness to policyholders. The disclosure of the most intimate basic financial data is assured, rigid sanctions are provided against false or misleading statements or advertising, and protection is afforded against impairment of capital.

VALIC may invest only in securities legal for investment by other life insurance companies incor-

[8] Public Law 85-334, approved February 22, 1958, made significant changes in the insurance laws of the District. It gave the Insurance Superintendent even greater regulatory powers. Since the Act was passed after the decision of the District Court, it becomes obvious that neither the Congress nor the Insurance Superintendent felt that it was necessary to have any enabling or specific, implementing legislation relative to the variable annuity.

porated in the District (L.I.A. § 35-535). Argument by petitioners that VALIC's investments are not adequately restricted amounts to a contention that Congress has not properly safeguarded the public in establishing its statutory standards for investments for life insurance companies, and in creating the Insurance Department to see that these statutes are observed.[9] No basis is asserted in any of the briefs below or in the petitions for certiorari for superseding this decision of Congress, and the implementation thereof through the District Insurance Superintendent.

In this connection it is pertinent to note both NASD/SEC have gone outside the record with respect to the purported views of the National Association of Insurance Commissioners and the National Association of Securities Administrators (NASD Pet. p. 9; SEC Pet. pp. 15-16). There is no uncertainty, however, in the views expressed by these Insurance Commissioners, the best-informed public officials in the insurance field:

> "4. supervision over the company including the issuance and sale of variable annuity contracts *should come under the jurisdiction of the state insurance department;*" (NASD Pet. Appendix C, p. 45)

Do Petitioners advance any reason which would lead this Court to retrace the ground so recently

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[9] The Investment Act of 1940 itself uses as its standard for face-amount certificate companies thereunder, and defines as "qualified investments" therefor, those investments "of a kind which life-insurance companies are permitted to invest in or hold under the provisions of the Code of the District of Columbia . . . Such investments shall be valued in accordance with the provisions of said Code where such provisions are applicable." § 28(b)

examined in the *National Casualty* case? VALIC will comment briefly on the four theories urged.

II

First, NASD (Pet. 10) and SEC (Pet. 7) argue that the Court of Appeals erred in rejecting the NASD/SEC claim that VALIC's variable life annuity policies are "securities" within the definition in the Securities Act of 1933.

The inherent nature of life insurance and life annuity contracts issued by insurance companies under the supervision of insurance administrators differentiates them from securities required to be registered under the Act of 1933. H.R. Rep. No. 85, 73rd Cong., 1st Sess., p. 15 (1933), made this clear. There the Committee explained that § 3(a)(8) in that Act, exempting insurance policies, was inserted to make clear

> ". . . what is already implied in the Act, that insurance policies are not to be regarded as securities subject to the provisions of the Act. The insurance policy and like contracts are not regarded in the commercial world as securities offered to the public for investment purposes. The entire tenor of the Act would lead, even without this specific exemption, to the exclusion of insurance policies from the provisions of the Act, but the specific exemption is included to make misinterpretation impossible."

That a life annuity is not a "security" was settled in *Haberman* v. *Equitable Life Assurance Soc'y*, 224 F.2d 401, 225 F.2d 837 (5th Cir. 1955), certiorari denied 350 U.S. 948 (1956). The Texas Securities Act, on which that case turned, defined "security" in

terms identical to those of the Securities Act of 1933, but did *not* exempt "insurance . . . policy or annuity contract." The opinion in *Haberman* matched the inherent nature of the life annuity contract against the definition of "security" and concluded that a life annuity contract was not a "security."

No other result can follow objective analysis of the nature of "securities" as compared to a life annuity contract. Whether an individual security holder lives or dies has no significance to an organization issuing a security or to other holders of its securities. Each security holder receives the same payment as every other holder of the same class—and under exactly the same circumstances. Realization does not depend on any contingency of life peculiar to the holder as an individual, or his beneficiaries.

By contrast, a life annuity contract is one unit of a group activity for shifting and distributing the insurable risk of individual longevity. Save for sheer coincidence, each annuitant will receive an amount different from that of every other policyholder, an amount dominantly controlled by his age, sex and length of life. No arrangement could be further from the concept of a "security."

But, petitioners say the opinion below is in conflict with *SEC* v. *W. J. Howey Co.*, 328 U.S. 293 (1946), and *SEC* v. *C. M. Joiner Corp.*, 320 U.S. 344 (1943).

The *Howey* case sets forth the concept of a "security" under the 1933 Act as including an investment in a "common enterprise." Count One of the Complaint, on which the other Counts explicitly rest, is grounded wholly on the misconception that a variable life annuity policy is a share in a "common

enterprise." No less than eleven times the Complaint alleged in this Count the solving words "common enterprise" (R. 4-5).

Yet no Finding of Fact of the District Court, nor either of the opinions of the District Court or the Court of Appeals, even mentions "common enterprise." The term is conspicuously missing from the NASD/SEC briefs below and both petitions here.

Variable life annuities, like other insurance contracts, are the antithesis of a "common enterprise." The interest of each annuitant is inherently adverse to that of all other annuitants. The group pays and the annuitant prospers when he outlives his expectancy; the group gains and the annuitant loses when he dies early (R. 467).

Neither the trial court nor the Court of Appeals found anything in *Howey* or *Joiner* relevant to this controversy. Neither case was mentioned in either opinion. The contention that there is conflict between the holding below and the *Howey* and *Joiner* opinions of this Court is wholly without merit.

SEC gives no record reference (because none exists) to support their bald assertion that VALIC's policyholders bought or looked to the policy as a profit making venture.[10] (SEC Pet. 8-9)

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[10] Income and estate taxes make completely unrealistic any argument that a variable annuity can be used as a "speculation." We note two illustrative facts:

Should an annuitant elect to take the cash surrender value of his policy during or at the end of the premium payment period, any resulting excess of receipt over cost would be taxed *as ordinary income, not capital gains.* I.R.C. § 72(e); U.S. Treas. Reg. § 1-72-11 (1956).

Should an annuitant die, any excess of the cash value of his

The reasons for buying an annuity differ basically from those for buying a security. In applying for a variable annuity, the motive is two-fold. Primarily the purchaser wants to insure an income guaranteed to continue for as long as he may live. Subordinately, he seeks an annuity on which payments will tend to equalize with the changing purchasing power of the dollar; or putting it another way, he seeks to protect himself from continuing loss of purchasing power *because of inflation.*

The motivation of the policyholder is clearly expressed in the opinion of the Circuit Court:

> ". . . the most important risk that the purchaser desires to shift when he buys an annuity is the risk that he will live longer than his funds will last."

As variable annuities are not "securities," they do not come within the Securities Act of 1933 or the Investment Company Act of 1940. The latter Act is applicable only to an "issuer" of a "security" (§§ 2(a)(21) and 3(a)).

If variable annuities were "securities," the Investment Company Act would make their issuance impossible, despite their approval by the District Insurance

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policy over premiums paid, realized at death, will be taxed both as ordinary income and as a part of his estate. Any survivor annuity is included in the gross estate at replacement cost including "loading." I.R.C. § 2039(a); U.S. Treas. Reg. 105, § 81.10(i)(1). Proceeds payable to a beneficiary, or to the estate are included in the gross estate. I.R.C. § 2039(a). But the survivor, beneficiary or estate does not receive a stepped up basis for later taxation (I.R.C. § 1014(b)(9)(A)).

Superintendent, since Section 18(f) makes it unlawful for an open-end investment company to have any class of security with a claim on its assets senior to that of its stockholders, and Section 18(a)(1)(A) makes it unlawful for a closed-end investment company to issue an obligation having such a senior claim unless it has an asset coverage of 300%. Both, of course, would *bar* the policies approved by the District Insurance Superintendent. This would not result in SEC regulation but in the *utter destruction* of VALIC.

The Investment Company Act of 1940 is, of course, expressly not applicable to an "insurance company." § 3(c)(3)

III

Secondly, petitioners argue (NASD Pet. 11; SEC Pet. 10) that the Court of Appeals erred in rejecting the NASD/SEC claim that VALIC's variable life annuity policies are not exempt under § 3(a)(8) of the 1933 Act. Two arguments are advanced, both rejected below:

(a) Petitioners say that an insurance contract is not an "annuity" unless it fixes in advance stated and unalterable dollar amounts for all annuity payments. The sole case authority[11] relied upon is an 1856 opinion by a New York surrogate (*Booth* v. *Ammerman,* 4 Brad. Surr. 129), which determined the date upon which interest would begin to run on a legacy of "the interest upon $1500" to be paid to a lady during

[11] NASD also cites in a footnote (Pet. p. 12) a trade journal article. This Court is respectfully referred to the scholarly article by Day, "A Variable Annuity Is *Not* a Security," 32 Notre Dame Lawyer 643 (1957).

the uncertain period, not of her life, but of her widowhood. A case more "inapposite" to the present issues could hardly be selected.

There is no contention by petitioners that any provision in the Life Insurance Act requires that life annuities be payable in a fixed and frozen number of dollars. The ruling to the contrary by the District Corporation Counsel and the District Insurance Superintendent stands unchallenged.

The argument that fixed and frozen dollar payments are essential to the insurance concept was specifically rejected, under analogous New York statutes, in *In re Supreme or Cosmopolitan Council of Brotherhood of Commonwealth,* 193 Misc. 996, 86 N.Y.S. 2d 127 (Sup. Ct. 1949).

The argument that fixed and frozen payments are essential to annuities likewise runs counter to Federal Income Tax Regulation § 1.72(b)(3), providing the same tax treatment as for fixed annuities for annuities in which "the amount of the periodic payments may vary with investment experience."

In enacting the Securities Act of 1933, Congress intended to extend federal regulation to an otherwise inadequately supervised field: the sale of securities. In excluding from the Securities Act the contracts issued by insurance companies, Congress did not rely on verbal definitions inviting semantic battles. It chose a pragmatic, concrete test which was not susceptible of mistake: the insurance or annuity contract was to be one issued by a company supervised by state or District insurance authorities. Obviously, VALIC satisfies this test.

Aside from statutory clauses required in certain policies (e.g. cash surrender value, and non-forfeiture provisions), there are no standard forms of insurance policies, and insurers design and seek approval of policies offering improved forms of insurance service as new needs, or new solutions for old needs, are discerned (NASD/SEC expert, R. 227).

> "It has been estimated that more than half of all life insurance in force today represents uses of insurance protection which have either been introduced or received their major development in the past 25 years. Included are the family income plans . . . retirement income insurance . . ." etc. (1956 LIFE INSURANCE FACT BOOK, being Ct. Ex. 1, not printed, p. 12)

Congress recognized and relied upon the "expertise" existing in the insurance departments of the states and the District. Congress made clear that it did not intend to subject the insurance industry and its policyholders to the confusion and the expense which would be inevitable if it launched a Federal agency, such as SEC or FTC into insurance regulation.

There is not the slightest support, either in the language or the legislative history of the 1933 Act for the contention that Congress intended by that statute to freeze insurance coverage within the forms that had been employed prior to its enactment.

Recently the government argued in this Court that health insurance "should be limited to the particular forms of insurance conventionally made available". This Court rejected that contention in the absence of support therefor in the legislative history or the definitions of the Act involved. *Haynes* v. *U. S.*, 353 U.S. 82 (1957).

(b) NASD, as a second subpoint under its claim that VALIC's policies are not life insurance annuities, asserts (Pet. p. 13) that the opinion below conflicts with *Helvering* v. *LeGierse,* 312 U.S. 531 (1941).

The *LeGierse* case and *Keller* v. *Commissioner of Internal Revenue,* 312 U.S. 543 (1941), were tax cases concerned with an arrangement whereby an insurance company simultaneously sold to a purchaser (i) a life insurance policy and (ii) an immediate life annuity. Actuarially, the premiums were so calculated that the ostensible mortality risks cancelled out. For the long-lived, annuity payments were offset by deferral of payment of life insurance. Early death matured the life insurance payment but cancelled the annuity obligation. This Court held that the funds derived from such an arrangement were not received as "insurance" under the tax laws. As stated in *Helvering* v. *Tyler,* 111 F.2d 422, 426 (8th Cir. 1940), "the *company assumed no pecuniary risk in respect of the duration of Mr. Tyler's life.*"

This pecuniary risk incident to the duration of life is precisely the risk which VALIC and any other life insurance company *does* assume. Clearly there is no conflict between the decisions of lower courts and *LeGierse* or *Keller.*

IV

Thirdly, NASD asserts (p. 14) and SEC implies (p. 16-17) that this Court should grant the writ on the theory that the holding of the Court of Appeals conflicts with the decision of the Supreme Court of Errors for the State of Connecticut in *Spellacy* v. *American Life Insurance Co.,* 144 Conn. 346, 131 A.2d

834 (1957). This makeweight argument is so superficial it hardly merits notice.

In *Spellacy,* the Connecticut court, on the petition of the state *Insurance Commissioner,* merely held that under the Connecticut *insurance statutes* a fraternal benefit society was not authorized to issue a proposed form of endowment contract. Accordingly, this contract was never sold by the company. The SEC Petition, p. 17, which purports to describe the contract as one being currently offered simply misstates the facts. The Connecticut Court did not hold that the proposed policy was a "security" and its reference to variable annuities was pure dictum, not within any of the questions reserved for the decision of the appellate court.

To assert that this Court should review the considered decision of the Court of Appeals because of a gratuitous dictum in an unrelated Connecticut decision dealing with different statutes and different facts evidences something little short of desperation.

SEC also relies upon *Coastal States Life Insurance Company* v. *Kelly,* Court of Common Pleas, Richmond County, So. Car.; and argues that in that case the court passed "upon a contract substantially identical to the variable annuity." (Pet. 16).

The contract involved in that litigation had *no* features either resembling or relating to the variable annuity. *Coastal States,* a Georgia company, offered in South Carolina a policy which included provisions labeled "Estate Builder Contract". These provided "interim endowments" of $100 a year for 18 years (the first a double amount, $200, after 2 years). The sole issue was the applicability to such provisions of So. Car. Code (1952) § 37-145, prohibiting an *insur-*

ance company from issuing any contract offering an "inducement to the taking of insurance." The *Insurance Superintendent* of South Carolina prohibited issuance of the policy on the ground that the estate provision constituted such an "inducement" and the Court sustained him.

In neither the *Spellacy* case nor the *Coastal States* case was there an attempt to enforce a "securities" law. Each determined whether a particular contract was permissible under the insurance laws of the state involved. Each upheld the local insurance commissioner and clearly illustrates the effectiveness of *state* insurance regulations. Neither gives any support to the theory that SEC should supersede state insurance authority.

V

Finally, Petitioners assert that this Court should review the decision below because "it introduces a novel and legally unwarranted test under the Securities Act which is administratively impractical" (NASD Pet. p. 15); or as somewhat differently stated by SEC "will hamper effective enforcement" of the securities statutes (Pet. p. 13); or "oust" SEC "of currently exercised jurisdiction" (Pet. p. 18).

Even if it were proper—which it is not—to decide this case on concepts of "administrative practicability" rather than on the pertinent statutory and decisional authority, the judgments below are manifestly correct.

Nothing could be more "administratively impractical" than having the SEC "second-guess" the forty-eight state insurance administrators with respect to

the operations of the 1,144 United States life insurance companies.[12]

New policy forms are under constant development as the industry has adapted its product to changing public needs (R. 411).[13] When an insurance commissioner in the daily conduct of his duties is called upon to determine whether he will approve a proposed new policy form, is he first to send it to the SEC for information as to whether the SEC thinks the policy is a "security"? Nothing could create greater administrative confusion. The insurance commissioner's function is to determine whether a proposed policy offers a lawful and otherwise appropriate insurance coverage under the state law he administers. If so, he approves it; if not, he disapproves it. On occasion, as in the *Spellacy* case, he may seek judicial guidance as to the interpretation of the *insurance* laws of his State.

But nothing in the federal system, especially in the light of the McCarran-Ferguson Act, suggests that the

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[12] As of June 30, 1956, there were 1,144 life insurance companies organized in the United States. 1957, LIFE INSURANCE FACT BOOK, p. 48.

[13] For example the family plan policy, first introduced in August, 1956, accounted for 20% of all ordinary life insurance bought in 1957.

"Purchases of life insurance by American families in 1957 reached a record $66.7 billion . . ., $11.4 billion or 21% more than in 1956.

• • • •

"Some of the 1957 increase in the average size ordinary policy purchased came from the large volume of *family plan* insurance sold in the year . . . In 1957, there were *800,000* family plan insurance policies purchased to cover *3.2 million persons* for a total of $8.5 billion of protection. The family plan purchases totaled nearly 20% of all ordinary life insurance bought in 1957." Life Insurance Fact Book (1958) pp. 19-21.

state insurance commissioners, *who are regulating in fact,* are to be made subordinates of SEC, or any other Federal agency, exercising their administrative functions at its sufferance. Congress, which enacted both the District Code (including the L.I.A.) and the Securities Acts, carefully included the District of Columbia within the definition of a "State" in the McCarran-Ferguson Act and expressly provided therein that "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of *regulating* the business of insurance . . ., *unless* such Act *specifically* relates to the business of insurance." (§ 1012(b)). Hence, it is clear that Congress did not intend that the District Insurance Superintendent and SEC should regulate the same activity.

In arguing that the decision below will "hamper effective enforcement" by it of the securities acts, SEC relies on the provisions therein that there "may be concurrent regulation by the Securities Exchange Commission and state commissions" (SEC Pet. p. 13). This argument is specious. The "state commissions" with which SEC is to have concurrent jurisdiction are the state *securities* commissions. Securities Act, 15 U.S.C. § 77r; Investment Company Act, 15 U.S.C. §80a-49). The express language of the McCarran-Ferguson Act, as well as its clear intent, shows, as the Circuit Court said, "an unmistakable determination on the part of Congress to *leave* the insurance business in the control of the States until Congress should in plain terms exert its power over some or all aspects of it."

NASD (Pet. p. 15) inquires what the variable annuity policy is "in a state such as Connecticut, which says it is not" insurance. The answer, of course, is simple

and self-evident. Under the Connecticut statutes as now worded, if they ultimately are construed in harmony with the dictum in the *Spellacy* case, a life insurance company will not be authorized by the Connecticut Insurance Commissioner to sell variable annuity policies without legislative sanction. Since only a life insurance company can sell these contracts, a resident of Connecticut will not be able to buy a variable life annuity from a company operating in that state.

The choices are not, as NASD (Pet. p. 15) suggests, between "insurance," "investment contract" (i.e. "security"), and "a scheme beyond control." The variable life annuity contract unquestionably is insurance; the choice of the state is merely whether under its own applicable insurance statutes life insurance companies authorized to transact business within its boundaries may properly be authorized to offer this type of retirement protection to the public.

This state-by-state development of the insurance industry was precisely what Congress envisaged in passing the McCarran-Ferguson Act. As this Court stated in *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408 at 429-30 (1946), in enacting the McCarran-Ferguson Act:

> "... Congress must have had full knowledge of the nation-wide existence of state systems of regulation and taxation; *of the fact that they differ greatly in the scope and character of the regulations imposed* and of the taxes enacted ... Congress could not have been unacquainted with these facts and its purpose was evidently to throw the whole weight of its power behind the state systems, *notwithstanding these variations.*"

The decisions below effectuated this Congressional intent. Since only life insurance companies, under state insurance supervision, can offer variable life annuity contracts, a fact conceded by everyone, it is a conspicuously idle gesture which NASD here solicits from this Court: an advisory opinion as to what a variable life annuity contract "is" in a state where under the current interpretation of the current insurance statutes such an insurance contract is not sold.

The suggestion (SEC Pet. p. 18) that it would be a simple matter for persons managing mutual fund investment companies to add a periodic accumulation plan with an " 'annuity' " provision is, of course, consistent with the studied effort of SEC throughout this litigation to ignore the existence and scope of insurance laws and regulations. If this were such a simple matter, obviously NASD, the trade association of the investment industry, would not be here in an effort to destroy through litigation this little insurance company.

All mutual fund investment companies are formed under the *general* corporation laws of a state which expressly exclude insurance companies. Accordingly, all life insurance companies are formed under the *insurance* laws of a state. No mutual fund investment company could amend its charter under the applicable general corporation laws so as to authorize the variable annuity. This is clearly illustrated by the recent action of Investors Diversified Services, a mutual fund investment company which formed Investors Syndicate Life Insurance and Annuity Co., a wholly owned subsidiary, to write the variable annuity. In such case, SEC continues to regulate the mutual fund investment com-

pany, and the insurance commissioner will regulate the life insurance company. Hence, there is no conflict; neither is SEC ousted of jurisdiction.

The decisions below are not in conflict with the decision of any court, State or Federal.

CONCLUSION

For the foregoing reasons, the Petitions for Writs of Certiorari should be denied.

Respectfully submitted,

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APPENDIX I

The McCarran-Ferguson Insurance Regulation Act (Act of March 9, 1945; c. 20; 59 Stat. 33, as amended; U.S.C. Title 15, § 1011-1015):

§ 1011.

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012.

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

§ 1013.

(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, and the Act of June 19, 1936,

known as the Robinson-Patman Anti-discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

§ 1014.

Nothing contained in this chapter shall be construed to affect in any manner the application to the Business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

§ 1015.

As used in this chapter, the term "State" includes the several States, Alaska, Hawaii, Puerto Rico, Guam, and the District of Columbia.